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Not for profit organisations face significant challenges in managing organisational risk. In this regard not-for-profits are not unique but they are distinguishable from their 'for-profit' counterparts in that they are less likely to have the resources to find sufficient risk management strategies and plans, are very vulnerable to cyclical changes in the insurance market and are not usually in a position to pass on the costs of increased premiums to third parties such as consumers of their services.

This article explores the nature and extent of risks faced by the not-for-profit sector; the appropriateness and scope of risk management to reduce and manage the likelihood and incidence of risk; and the types of insurance and options to cover risks that materialise. It concludes with a recommendation for a potential course of action.

# Not-for-profits, risk management and insurance

**Julie-Anne Tarr***

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## INTRODUCTION

The not-for-profit or non-profit sector (NFP) sector is large and diverse, with around 600,000 organisations, some 440,000 being small unincorporated organisations. Of the remainder, the Australian Bureau of Statistics has identified 59,000 economically significant NFPs who employed 889,900 staff, around 8% of employment, and contributed just under $43 billion to Australia's GDP in 2006-2007. Over 4.6 million Australians volunteered with NFPs in 2006-2007[1].

These NFPs and community organisations face significant challenges in managing organisational risk. In this NFPs are not unique but they are distinguishable from their "for-profit" counterparts in that they are less likely to have the resources to fund sufficient risk management strategies and plans, are very vulnerable to cyclical changes in the insurance market and are not usually in a position to pass on the costs of increased premiums to third parties such as consumers of their services.

For purposes of this article the definition of risk contained in the Australian and New Zealand Standard on Risk Management[2] is adopted; namely:

> The chance of something happening that will have an impact upon objectives. It is measured in terms of consequences and likelihood.

NFPs are exposed to the full spectrum of risks faced by any organisation operating a business of providing services in an increasingly complex and connected market. Clearly the particular nature of the NFP or community service organisation will impact upon specific risks or the likelihood of certain risks materialising. However, it is clear that there are certain exposures that are more common than others. For example, in a survey of 388 organisations in South Australia covering a wide range of services, it was found that 50% of the total sample had made an insurance claim over the period 2001-2004 and the greater proportion of these claims were for workers' compensation, followed by motor vehicle accidents.[3]

A review of the insurances in place across a variety of NFPs disclose a comprehensive array of policies designed to respond to the many and varied risks. For example, the Uniting Church in

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[1] See Australian Government Productivity Commission, *Contribution of the Not-for-Profit Sector, Research Report* (11 February 2010) Ch 4, http://www.pc.gov.au/projects/study/not-for-profit/report viewed 10 September 2011.

[2] AS/NZS 4360:1999 Risk management.

[3] Verity F, "Insurance and Risk Management: Unravelling Civil Society", *South Australian Policy Online* (May 2005) p 7, http://www.sacoss.org.au/publications/unravelling_civil_society.pdf viewed 10 September 2011.

Australia[4] Queensland Synod maintains an insurance program providing protection to all buildings and contents in respect of physical loss or damage; machinery and electronic equipment breakdown; motor vehicles; fidelity guarantee; personal accident; public and products liability; professional indemnity; directors and officers liability and employment practices liability. Organisations such as the Lions Clubs International[5] and Volunteering Queensland[6] disclose a similar spectrum of recommended covers to cater for property, liability and other risks.

NFPs in confronting risks face the same challenges as business and society generally with a more litigious culture generating more claims. No entity is an island. As Jeffrey W Hanna[7] laments:

> We think of congregations as places of rest, safety, and nourishment for souls. We are shocked when we hear that a pastor's, leader's or teacher's conduct has been called into question. We are amazed when we read that those entrusted with church finances are accused of embezzlement. We cry as we learn that someone in the family of God has been sexually or physically harmed. We shake our heads when we hear that the church building down the road has been broken into, damage has been done, and valuables have been taken. We cringe as we listen to the details of a congregation being sued.

Not even churches are untouched by the full range of risks and responsibilities more readily apparent in the secular context.

Non-profits also face particular challenges deriving from funding arrangements. The significance of this funding cannot be underestimated. For example, the New South Wales Government provides over $1.5 billion in funding annually to just under 2,350 human services non-government organisations to deliver on going community-based services across NSW. Similarly the Queensland Government provided $1.067 billion for grants and $163 million in capital grants to not-for-profit organisations in 2008-2009.[8] As McGregor-Lowndes and Ryan[9] describe in their paper dealing with risk allocation, agreements between governments and NFP organisations for the provision of community services have usually contained provisions for specified insurances to be taken out by the contractor and for an indemnity in favour of the government. These requirements may be imposed in an inflexible manner excluding opportunities for other ways to manage risk or to self-insure lower levels of risk.[10] The width of certain indemnities may also place non-profits in extremely difficult circumstances. The Australian Productivity Commission[11] reports that some current approaches adopted by governments to the management of the different risks involved in the delivery of services on their behalf are not cost-effective and that an explicit risk management framework should be prepared by government agencies in collaboration with service providers as part of their contracting process. The Commission concluded:

> Consultations and submissions suggest that poor risk management by government agencies is leading to inappropriate cost shifting. It is unlikely that this is because government agencies are unaware of the overarching principle that risk should be allocated to the party best able to bear it. Implicit in this principle is the obvious point that governments should focus on managing risk rather than seeking to eliminate it.[12]

## RISK MANAGEMENT

Risk management refers to a "logical and systematic method of establishing the context, identifying, analysing, evaluating treating, and monitoring and communicating risks associated with any activity,

[4] See UC Insurance, *Insurance Handbook for Uniting Church Congregations* (The Uniting Church in Australia Queensland Synod Indemnity Fund, 2009).

[5] Lions Club International, *A Guide to Insurance for Lions Clubs International Multiple District 105* (April 2005).

[6] Volunteering Queensland; see http://www.volqld.org.au viewed 10 September 2011.

[7] Alban Institute, *Safe and Secure: The Alban Guide to Protecting Your Congregation* (1999).

[8] See Australian Government Productivity Commission, n 1, p 301.

[9] McGregor-Lowndes M and Ryan CM, "Who Should Bear the Risk? The Party Least Able to Refuse or the Party Best Able to Manage the Risk" (Paper for the Accountability, Governance and Performance Symposium, Queensland University of Technology Business School, 17 February 2006).

[10] McGregor and Ryan, n 9, p 11.

[11] See Australian Government Productivity Commission, n 1, p 301

[12] Australian Government Productivity Commission, n 1, p 337.

function or process in a way that will enable organisations to minimise losses and maximise opportunities".[13] NFP organisations are giving increasing prominence to implementing risk management strategies and plans for a variety of reasons.

The principal justification for a strong risk management emphasis is that it may reduce the actual likelihood and incidence of civil liability and other risks materialising.[14] Standards Australia maintain that risk management is an integral part of good management practice[15] and there can be little debate that a preferred outcome must be the prevention of harm or other adverse consequences, rather than compensation after the event or injury. Volunteering Australia Inc[16] is a strong advocate of risk management as it is a process whereby an organisation can identify risks in order to prevent them or reduce them and to provide for funds to meet any liability that may occur.

A second major justification for a strong risk management strategy is that it will assist the organisation to negotiate a better outcome in the insurance market. For example, the Australian managing director of Sportscover, Mr Peter Nash, reported that sports associations which embraced risk management principles could see a 20% reduction in their public liability premium. Citing BMX, Australian Rules Football, rugby and soccer, he observed that there had been a decrease in incidents leading to claims where risk management principles had been adopted.[17]

The Australian Productivity Commission[18] recommends that the Australian and State governments should take immediate steps in consultation with NFP service providers to embed good risk management practices within procurement and funding processes. This would provide a way of helping build a common understanding of the risks associated with providing a service; ensuring there is clarity about who bears those risks; and encouraging a sense of ownership of the actions needed to appropriately manage and respond to risk.

Numerous approaches exist to the development of an effective risk management plan. Standards Australia identifies seven main elements to the risk management process.[19] These are well encapsulated and illustrated in the Volunteering Australia booklet on risk management as follows:

Step 1: Identify the Risks

Step 2: Evaluate the Risks

Step 3: Decide on the Strategies (such as risk avoidance, risk control, risk financing, risk transfer)

Step 4: Implement, monitor and review the Program.[20]

All organisations emphasise that to be most effective risk management needs to be embedded as part of an organisation's culture. As Standards Australia observes it must be integrated into the "organisation's philosophy and business plans rather than be viewed or practised as a separate program".[21] This, of course, is no different to how successful workplace health and safety plans must be inculcated into the mainstream of the organisation and its business or service delivery.

In developing risk management plans it must be recognised and borne in mind that no non-profit advances without taking risks. While risk management provides a process whereby risks may be identified, analysed and addressed there is, paradoxically, a risk of inertia that may derive from the very process of risk management. The Non-profit Risk Management Center[22] makes the point that the introduction of a new service, undertaking a new fund raising initiative or collaborating with a new partner all entails new risks. Effective risk management provides a framework not only to evaluate risks but to *take* risks in informed circumstances.

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[13] AS/NZS 4360 1999 Risk Management.

[14] See McGregor-Lowndes M, "Sustainable Solutions to Civil Liability Project", Submission to the Brisbane City Council, Centre for Philanthropy and Non-profit Studies (2004) p 5.

[15] AS/NZS 4360:1999 Risk Management.

[16] Commonwealth of Australia, Running the Risk? Risk Management for Volunteer Involving Organisations (, 2003) p 3.

[17] See *The Risk Report* (10 June 2004) p 7. [AQ: Pls supply author or publisher]

[18] Australian Government Productivity Commission, n 1, pp 337, 338.

[19] AS/NZS 4360:1999 Risk Management, Section 4.

[20] AS/NZS 4360:1999 Risk Management Note 12, pp 10-17.

[21] AS/NZS 4360:1999, Risk Management, p iii.

[22] Herman ML (ed), *Coverage, Claims & Consequences: An Insurance Handbook for Nonprofits* (Non-profit Risk Management Center, 2002), p 5.

Caution must also be exercised, according to Verity,[23] to ensure that risk management strategies do not change the organisation in ways detrimental to its mission or traditional goals. Citing Waterson,[24] Verity makes the point that a focus on risk in planning and service delivery is increasingly on "negative risk" supplanting "risk taking" as a response to need and empowerments. Risk management is not a neutral or value free undertaking and every step of the risk management decision – making process requires value judgments about what constitutes a risk and what level of risk is bearable or desirable.

It is therefore not surprisingly that risk management strategies and plans are very variable in their effectiveness and in how comprehensive they are. They are greatly dependent upon the skills and knowledge of those devising them and the judgment calls they make in analysing, identifying and prioritising risk. In addition it must be emphasised that risk management plans are more efficient and effective if based upon comprehensive and comparative data. For example, if a plan is based upon data procured from a broad spectrum of community organisations and their experiences in diverse contexts, it is less likely that risks will be omitted from consideration and treatment.

## INSURANCE

The Non-profit Risk Management Center comments that:

> Non-profits purchase insurance for any number of reasons. Many non-profit managements believe that insurance is the most effective way to finance risk and, therein, to protect the organisation's financial and physical assets. Although every non-profit has some risk control measures in place – staff screening programs, driver training, contract reviews and other measures to prevent accidents and missteps – insurance provides a funding mechanism to pay for losses or finance the risk of loss. Risk financing through insurance provides the funds to pay for the non-profits; unexpected losses of people, property and income, while ultimately keeping the organisation in operation.[25]

Various approaches can be taken to arranging or procuring insurance cover. In addition there is scope for non-profits to look at non-traditional risk financing models and at self-insurance or risk retention strategies. This section of the article will explore some critical issues and options for non-profits.

### Captive insurer

A captive insurer in this context would be a company formed for the express purpose of insuring the exposures of a NFP or community organisation. Clearly this option would only be realistic for very large NFP organisations such as religious bodies or hospitals as the establishment of a separate Board and Company to conduct the business carries overhead costs and solvency requirements for insurers require significant capital. However, for large non-profits there are major advantages. The organisation gains direct control over their insurance program and can integrate that program more seamlessly with their risk management strategies and plan.

By taking direct control the NFP is able to construct a program that balances risk retention and reinsurance imperatives. For example, it could be decided that the captive insurer would assume responsibility for all claims in a financial year to an aggregate limit of $5 million for losses exceeding $10,000 and below $500,000. For losses exceeding $500,000 stop loss protection could be purchased from reinsurers and reinsurance cover would also cover the losses in excess of the annual aggregate retention of $5 million. Devising a program to suit the NFP enables the organisation to gain more control over their insurance program and to take direct responsibility for their claims handling within the limits established by themselves.

In addition one of "often touted benefits of a captive is the opportunity to gain a deeper understanding of the organisation's or association's losses and the best strategies for controlling losses".[26]

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[23] See Verity, n 3, p 5.

[24] Waterson J, "Redefining Community Care Social Work: Needs or Risks Led?" (1999) 7(4) *Health and Social Care in the Community* 276.

[25] Herman, n 22, p 1.

[26] Herman, n 22, p 190.

## Mutual insurer

A mutual insurer is a NFP that operates in a fashion similar to a pool. A good example is the Nonprofits Insurance Alliance of California (NIAC) which is a charitable risk pool owned by s 501(c)(3) tax exempt NFP organisations in California, insuring more than 2,800 non-profits in that State beginning its operations in 2001, the Alliance of Nonprofits for Insurance Risk Retention Group (ANI-RRG) was established to provide insurance and risk management services outside California and, like NIAC, is a tax exempt NFP owned by its member non-profits.

These organisations provide a wide range of insurance covers including general liability, directors and officers cover, motor vehicle, property and accident cover. In addition to providing insurance cover these member-owned insurers provide a variety of free risk management and loss control services including driver training, newsletters, educational booklets and a video lending library.[27]

The degree of control by individual NFP organisations who are members of a mutual insurance company is obviously less than in the captive situation as there are large numbers of members. However, the non-profits do have an ownership interest and there is capacity based on better data through claims experience to tailor risk management strategies more effectively.

## Risk financing pools or mutual funds

Short of creating a separate mutual insurer it is possible to establish a completely self-insured/managed fund. The usual methodology for a self-managed mutual fund involves a self-managed component combined with traditional insurance. Not unlike the captive scenario described above, an aggregate limit is determined up to which all claims are addressed by the administrators of the fund. Should this aggregate limit be exceeded, then an insurer or reinsurer could cover those claims, thereby removing financial risks from the fund. Such funds are usually administered on a fee-for-service basis by external managers with appropriate expertise and the mutual scheme itself is funded by the member organisations. The total funding required for the program would be: an amount equal to the aggregate limit to be met by the fund, plus the cost of any insurance or reinsurance cover to deal with claims in excess of the aggregate (if any) plus a fee to the administrators of the fund. As McGregor-Lowndes observes:

> In theory, this will be less than what would have been required for a normal traditional insurance program as there are savings on government charges and GST. The profit margin of the traditional insurer is removed and administration expenses may well be less than what an insurer would have allowed for in their premium. Further advantages are that any surplus is retained by the fund (greater incentive to embrace risk management), there is potential for investment income and the sector does have ownership of the program and control over benefits and claims management.[28]

The principal risk faced by mutual schemes is that of under-insurance. There needs to be adequate insurance or reinsurance cover to cater for losses that exceed the aggregate liability retained by the fund. If the insurance cover is inadequate there will be uninsured losses which will have to be met by the members of the fund. As community organisations have only minimal reserves a significant uninsured loss could affect the ongoing viability of the whole sector of organisations under the scheme.

## Group purchasing options

Where captive insurance, mutual insurance or pools are not viable options there may still be benefit in pursuing group purchasing options. In this situation non-profits or community organisations can bring economies of scale to the administration and purchase of insurance cover. Group buying or pooling occurs where the insureds under a policy are increased in number and/or quantum of cover by including other organisations under the same insurance policy.

## Piggy-backing

There is limited scope for volunteers within NFP organisations to avail themselves of protection against liability for volunteering activity by relying upon their own personal insurance cover. This arises in the context of household insurance policies and motor vehicle insurance.

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[27] For example, publications include: *Managing Volunteers: Balancing Risk and Reward*; *Non-Profit Directors and Officers: Key Facts about Insurance and Legal Liability*; and *Sound Advice for Functions and Events: Tips to Help your Non-profit Stage Safer Special Events*. See http://www.insurancefornonprofits.org viewed 10 September 2011.

[28] Centre for Philanthropy and Nonprofit Studies, "Sustainable Solutions to Civil Liability Project", Submission to the Brisbane City Council, Centre for Philanthropy and Nonprofit Studies (2004) pp 12-13.

Household insurance policies commonly provide public liability coverage which is drafted widely enough to cover activities undertaken by a volunteer. For example, the Royal Automobile Club of Queensland (RACQ) home and contents policy will cover the insured and any person residing at the insured property's address, other than a boarder, for legal liability which arises during the period of insurance and occurs within Australia. The maximum amount payable is $20 million less any excess and includes legal costs. An analysis of 14 widely used home and contents policies in Australia reveal similar provisions. There are certain exclusions that are generally common to all policies such as where the liability to pay compensation arising from an incident which causes death or bodily injury to those outside the household or loss or damage to their property arises from:

(a) any intentional act or omission; or

(b) any act or omission that demonstrates a reckless disregard for the consequences of the act or omission; or

(c) a deliberate and unlawful act by the insured; or

(d) and business trade or profession; or

(e) any professional, recreational or amateur sporting activity.

Every policy will have variations in the exclusions to some degree but there is a common underlying principle that the policies will not respond where the conduct or omission causing harm or loss is intentional or unlawful, or where the insured is being paid for the activity being undertaken when the loss or damage is caused. Accordingly while household insurance policies might respond to offer protection to an insured who is volunteering his or her services to a community organisation extreme care is necessary to ensure that an exception does not apply.[29]

The same can be said for motor vehicle policies where it is clear that personal comprehensive car insurance will not cover liability, if the vehicle is being used for work-related purposes. The insured generally is covered for private purposes and although variously defined is generally taken to mean social, domestic and pleasure purposes .From a volunteer's perspective coverage is likely to be available where the insured is undertaking unpaid voluntary services for an organisation, but again caution must be exercised.

Reliance on personal or private insurance covers is, of course, supplemental to protections afforded to volunteers by legislation such as the *Civil Liability Act 2003* (Qld) which extends protection to volunteers. Volunteers working in registered NFP community organisations engaged in voluntary activities defined by the organisation are protected from legal action provided they are not acting outside the law.[30] This protection, like the "piggy-backing" on private insurance cover, is subject to constraints – in particular, the volunteer must be acting as instructed by the community organisation within the scope of authorised activities.

Civil liability law reform and private insurances, such as household and motor vehicle insurance, are factors to be taken into account in formulating risk management strategies and in devising the appropriate insurance portfolio for non-profits.

## CONCLUSION

NFP organisations face considerable challenges in managing risk and procuring appropriate insurance cover. Unlike other sectors of the economy, the non-profit sector has very limited resources to cover administrative expenses such as insurance and, in most cases, does not have the capacity to pass on costs through earned income.

Various non-traditional risk financing models have developed and grown. As discussed above, these include risk retention strategies, risk pools, mutual insurers and mutual funds and captive insurers. These non-traditional approaches are less essential in the context of a soft insurance market where adequate cover can be secured for sustainable premiums from the traditional market. With the collapse of the global soft insurance market in 2001, non-profits experienced great difficulty with sometimes dramatic premium increases, the withdrawal or restriction of cover, and a reduction in the number of insurers due to insolvency, contraction in business or restructuring by insurers. These problems were exacerbated in Australia by the collapse of HIH, which was providing unsustainably low premiums to many community organisations.[31] As the traditional insurance market has now made a substantial recovery there is less urgency and focus upon alternative insurance models and solutions than during the early years of this millennium. However, it is suggested that this affords a window of

[29] See eg, the AAMI, Allianz, APIA, Catholic CI, CGU, Commonwealth, Elders, ING, NRMA, QBE, RAC, RACQ, SGIC, SGIO, Suncorp, SWANN and Westpac policies.

[30] See http://www.legislation.qld.gov.au viewed 10 September 2011.

[31] Queensland Council of Social Service Inc, *Community Insurance Crisis: Resource Kit for Lobbying Government* (2004) p 2.

opportunity to explore the creation of a national NFP mutual insurer along the lines of the Californian entity.[32]

Such an entity with the support of expert broker, actuarial and accounting services would have the potential to achieve efficiencies and economies of scale for the NFP sector. In addition, there would be long-term benefits in the collection of claims data. This in turn would inform risk management strategies of which risks organisations should expend their scarce resources on managing as well as guide risk retention and mitigation initiatives.

While there is no question that risk management is an integral part of good management practice, the cautionary comments expressed earlier that risk management strategies should not subvert an organisation from its goals and mission must always be borne in mind. The discharge of NFP activities and services will involve risk taking – sound risk management should provide the framework within which those risks are undertaken but should not lead to inertia.

Non-profits depend to large measure upon the "active engagement and collective participation in a myriad of ways"[33] by the community. The insurance crisis in 2001 and the subsequent hardening of the market put many community organisations and participation by volunteers at risk due to availability or affordability of insurance cover. State and Federal Governments[34] have attempted to address structural issues in the insurance market by civil liability law reform, particularly in this context by extending protection to volunteers and their organisations in the circumstances described above. In addition, the notion of "piggy-backing" upon volunteers' household insurance policies which provide public liability coverage in broad enough terms to cover volunteering or motor vehicle policies with similar breadth of cover for personal injury or accident provide scope to broaden the protective umbrella for NFP organisations. Of course, caution must be exercised to ensure that this is very carefully considered and regularly reviewed as particular policy wording and exceptions with that policy will dictate outcomes.

Larger scale structural reform along the lines of the Accident Compensation scheme in New Zealand which provides no-fault accident compensation to all citizens no matter where or how they injure themselves, has not gained any traction in Australia. In the absence of such a nationalised tax and employer funded scheme providing administratively managed compensation, the task for non-profits is to devise carefully structured risk management plans that dovetail with effective insurance arrangements that cater for risks that eventuate, notwithstanding the best planning the NFP has undertaken.

[32] Nonprofits Insurance Alliance of California.

[33] Verity, n 3, p 6.

[34] See eg, the *Civil Liability Act 2003* (Qld).